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# In the Supreme Court of the United States

OCTOBER TERM, 1973.

## No. 73-781

FRITZ SCHERK,

*Petitioner,*

vs.

ALBERTO-CULVER COMPANY,

*Respondent.*

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

## PETITION OF RESPONDENT FOR REHEARING OF DECISION

Respondent, Alberto-Culver Company, respectfully requests the Court to reconsider its decision. It is Respondent's conviction that the Court may not have envisioned or intended the far-reaching effects which this decision will have in depriving American investors of the protections conferred by the securities laws of this country.

The majority opinion holds that the "anti-waiver" provision contained in section 29(a) of the Securities Ex-

change Act of 1934 ("1934 Act"), 15 U.S.C. §78cc(a), which declares "void" "any" attempted waiver of "any provision" of the 1934 Act, does not apply to "international" transactions. Similar "anti-waiver" provisions are found in the Securities Act of 1933, the Investment Company Act of 1940, and the Investment Advisers Act of 1940.

Accordingly, unless modified, the majority opinion will be regarded as pronouncing a rule that in "international" securities transactions an American investor, who is the victim of securities fraud committed by a foreigner in this country, is required to arbitrate and is denied the statutorily conferred right to have the securities violations adjudicated in the courts of the United States. The two-fold effect of the decision is to permit foreigners to avoid the application of our securities laws, *even as to securities fraud committed in this country,* by simply "specifying in advance" for either (1) arbitration before a remote tribunal or (2) the application of foreign substantive law.

## I

**ALTHOUGH THE OPINION OMITS ANY MENTION THAT THE SECURITIES FRAUD HERE OCCURRED IN THE UNITED STATES, SUCH UNDISPUTED FACT IS REFERRED TO IN THE DISSENTING OPINION AND BY THE COURTS BELOW. THEREFORE THE EFFECT OF THE MAJORITY OPINION IS TO ARM FOREIGNERS CONTEMPLATING SECURITIES FRAUD IN THE UNITED STATES WITH THE MEANS OF EVADING THE PROTECTION GIVEN AMERICAN INVESTORS BY THE SECURITIES LAWS**

The applicable statute in this case, section 29(a) of the 1934 Act, as well as the other aforementioned Acts de-

signed to protect the American investor, declare as "void" any attempt to waive any provision of the Act, and section 29(a) in no way differentiates arbitration clauses in domestic from those in international transactions. Nowhere does the majority opinion attempt to explain how its "international" exception can be squared with the unqualified language of section 29(a).

Nor does the majority opinion make any reference to the critical fact that the violations of the securities laws, which constitute the basis of Alberto's action to rescind, occurred within the boundaries of the United States. This was so found by the lower courts, is referred to in the dissent, and is unchallenged in the context of the proceedings before this Court.

The inescapable effect of the majority opinion will be to deprive the American investing public of vital protections conferred by the securities laws against violations within the United States. For example, a foreign broker selling foreign securities in this country or a foreign mutual fund or other foreign issuer selling its shares in this country may, by inserting an arbitration clause in the applicable contract, ignore or violate the registration and disclosure provisions of the Securities Act of 1933, the 1934 Act, and the Investment Company Act of 1940. The sole remedy of the American investing public would be to arbitrate, probably at a remote location and in any event in a tribunal which almost certainly will lack the expertise, discovery and other procedural mechanisms, or perhaps even the inclination for proper enforcement of the American securities laws. The opinion's rationale would enable a foreign investment adviser to enter this country and without registering to furnish fraudulent investment advice concerning foreign securities to American citizens in violation of the Investment Advisers Act

of 1940, and yet evade being held to account before the United States courts simply by providing for foreign arbitration in the documents creating his relationship with the American citizen.

The dissenting opinion correctly reasons that, in these times when foreigners are so active in American securities transactions, "[i]t is peculiarly appropriate that we adhere to *Wilko*—more so even than when *Wilko* was adopted". (Dissent, p. 8)[1] The majority opinion necessarily will prompt foreign nationals to use arbitration clauses in their securities dealings with American investors, *sophisticated and unsophisticated,* as a means of frustrating enforcement of the American securities laws by the tribunals most experienced and interested in enforcing them. We find it difficult to believe that the Court intended this result, and yet it most definitely follows from the majority decision.

These dangers are compounded by the Court's very broad definition of "international transaction" which appears to encompass "any contract touching two or more countries". (Slip Opinion, p. 9, and Dissent, p. 8) The only reservation suggested by the Court seems to be "where the contacts with *foreign* countries are so insignificant or attentuated . . ." (Slip Opinion, p. 10, note 11), regardless of how *significant* was the conduct *in the United States* constituting the securities fraud. By this approach the Court reverses established concepts as to what justifies jurisdiction over foreigners.[2]

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[1] *Wilko* v. *Swan,* 346 U.S. 427 (1953).

[2] See cases cited at footnote 3 of this Petition for Rehearing.

## II

## THE HAZARD TO THE AMERICAN INVESTING PUBLIC WHICH FLOWS FROM THE MAJORITY OPINION TRANSCENDS ANY CONJECTURAL BENEFIT TO INTERNATIONAL COMMERCE.

The crux of the Court's justification for departing from *Wilko* in international transactions is based on the hypothesis that not to enforce an arbitration provision in an "international" agreement will ". . . surely damage the fabric of international commerce and trade, and imperil the willingness and ability of businessmen to enter into international commercial agreements". (Slip Opinion, p. 10)

Is the majority hypothesis, that *legitimate* international commerce will suffer if securities fraud committed in this country is required to be adjudicated in the federal courts of this country, as realistic or pragmatic as the dissent's hypothesis that upholding arbitration of such fraud will aid, abet and encourage foreigners to violate our securities laws?

Concern for *legitimate* foreign business interests does not require the encouragement of those bent on committing securities fraud. This case poses the principle that where securities fraud is deliberately and knowingly committed by a foreigner within this country, *such fraud* (of which only the defrauding party was aware at the time the arbitration clause was adopted) should be tried before the American courts as is contemplated by the express provisions of our securities laws. Such a holding should in no way imperil legitimate international business or the use of legitimate arbitration provisions.

The dissent notes that the conclusion that foreign commerce will suffer is "supported only by speculation . . ." (Dissent, p. 9, note 7)

On the other hand, the concern that foreigners will use stipulations to arbitrate to evade proper enforcement of securities laws is reasonable and realistic. We have witnessed, and undoubtedly will continue to experience, massive securities frauds committed by foreigners against American citizens involving foreign securities.[3] The necessary consequences of the majority opinion will be to encourage such conduct by those who count on the lesser likelihood of being held to account in arbitral proceedings.

The opinion stresses the importance of "certainty" in international transactions. However, the Court's decision does not assure such certainty, since both the majority and the dissent recognize that at a later date a court might refuse to enforce a foreign arbitral award. (See Slip Opinion, pp. 12-13, note 14, and Dissent, p. 9, note 7) Moreover, the agreement between Alberto and Scherk did in fact provide certainty of forum and of applicable law. The forum selected was arbitration, except for violations of the American securities laws which, under *Wilko* and section 29(a) of the 1934 Act, had to be adjudicated. By specifying Illinois law, the parties incorporated the American securities laws as being applicable to their transaction and thereby expressly adopted "American standards of fairness". (Slip Opinion, p. 10, note 11) The certainty thereby resulting is not dissimilar to the certainty achieved under the majority view, and it is achieved with

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[3] See e.g., *Leasco Data Processing Equip. Corp.* v. *Maxwell*, 468 F.2d 1326, 1334-1339 (CA2 1972); *Travis* v. *Anthes Imperial Ltd.* 473 F.2d 515, 523-528 (CA8 1973); *SEC* v. *United Financial Group, Inc.*, 474 F.2d 354 (CA9 1973); *Schoenbaum* v. *Firstbrook* 405 F.2d 200 (CA2 1968); *Roth* v. *Fund of Funds*, 279 F.Supp. 935, aff'd; 405 F.2d 421 (CA2 1968).

out doing violence to the well-established statutory and judicial framework.

The American securities laws provide unique protections for the American investor which find no counterpart elsewhere in the world, and which in many respects are contrary to prevalent European notions.[4] To hold that this extraordinary and unique legal system, developed in the United States, should be enforced by the courts of and within the United States ought not to be construed as demeaning the standards of justice elsewhere in the world.

## III

## THE OPINION RAISES ISSUES AND LEAVES THEM UNDECIDED THEREBY IMPLYING THAT THIS COURT MAY WELL ENTERTAIN OTHER DEPARTURES FROM WELL-SETTLED SECURITIES PRECEDENTS.

Other features of the majority opinion should concern this Court and others entrusted with the proper enforcement of the securities laws.

The Court's discussion of the differences between the 1933 Act and the 1934 Act (Slip Opinion, pp. 6-8) implies that the Court might approve a decision whereby the *Wilko* doctrine is held totally inapplicable under the 1934 Act in domestic transactions as well as international. The Court has further suggested that *Wilko* might not apply to parties of equal bargaining power. (Slip Opinion, p. 6, note 6) The Court also questions whether Alberto's purchase of stock and issuance of promissory notes is a securities transaction within the coverage of the Act (See Slip

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[4] *Internationalization of Securities Markets,* The Business Lawyer, Vol. 29, March, 1974, 107, 109.

Opinion, p. 8, note 8), thus inviting a narrowing of the definition of what constitutes a security even though that subject was never raised or briefed before this Court.

## IV

## THE OPINION SUGGESTS THAT INTERNATIONAL TRANSACTIONS ARE NOT SUBJECT TO THE SUBSTANTIVE PROVISIONS OF THE SECURITIES LAWS AND THAT THE APPLICATION OF THESE SUBSTANTIVE PROVISIONS CAN BE AVOIDED SIMPLY BY DESIGNATING THE APPLICABLE LAW TO BE THAT OF A FOREIGN COUNTRY.

Of even greater concern to proper enforcement of the securities laws is the effect of the majority opinion on the substantive provisions of the securities laws even though the Court notes that the "decision has no bearing on the scope of the substantive provisions . . ." (Slip Opinion, p. 11, note 12) [5]

It is inescapable that the "international" exception which the Court pronounces will ignite consideration by

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[5] The attempt by the Court to differentiate between the substantive and procedural provisions of the 1934 Act is not only contrary to the language of section 29(a) of the Act, but also is a radical departure from *Wilko* (where this contention was argued and rejected), and from *Bernhardt* v. *Polygraphic Co.*, 350 U.S. 198 (1955) where this Court, at page 203 of the opinion, recognized that the procedure is an inseparable component of the substantive rights:

> "For the remedy by arbitration, whatever its merits or shortcomings, *substantially affects* the cause of action created by the state. *The nature of the tribunal where suits are tried is an important part of the parcel of rights behind a cause of action. The change from a court of law to an arbitration panel may make a radical difference in ultimate result . . .*" (Emphasis supplied)

lower courts as to whether this exception also applies to the substantive provisions, since it follows logically that international transactions exempted from some should similarly be exempted from other provisions of the securities laws. The text of the majority opinion directly suggests that there is "considerable uncertainty" whether any part of the federal securities laws apply to an international transaction. (See Slip Opinion, p. 9, and in particular note 9 and the portion of the opinion to which note 9 relates) Accordingly, notwithstanding the Court's disclaimer, the language and thrust of the opinion will necessarily encourage the review and possible overturn, and will promote uncertainty as to the status, of recent leading decisions which have held that foreign nationals who commit securities violations within this country are subject to American securities laws where jurisdictional requirements are satisfied.[6]

There is no reason to believe that foreigners and their counsel will leave these matters to the vicissitudes of case-by-case adjudication. The majority opinion advises them as to a method of achieving "certainty" of result. The opinion will activate a foreigner contemplating securities fraud in a securities transaction "touching two or more countries", but occurring in material part in the United States, to avoid both the substantive provisions of our securities laws and accountability in the United States courts simply by "specifying in advance . . . the law to be applied" as that of a foreign country. (Slip Opinion, p. 9) Indeed, the reasoning of the opinion would support a clause expressly *excluding* the applicability of the securities laws in international transactions. The "certainty" thereby achieved is the certainty that our laws can be circumvented with impunity.

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[6] See cases cited at footnote 3 of this Petition for Rehearing.

## V

## CONCLUSION

The substantive and procedural protections to American investors under the securities laws, painstakingly evolved both judicially and statutorily during the past four decades, are seriously eroded, impaired and left uncertain by this decision to an extent which we believe may be far beyond what the Court foresaw or intended. It should be of particular concern and apprehension both to the Court and to those most intimately entrusted with the day-by-day workings of the securities regulatory system, that the opinion raises and then leaves hanging several vital issues, thereby implying that in any international securities transaction and in some domestic transactions the Court may be amenable to further erosions of the protections provided by the statutory and regulatory scheme.

The opinion may not have taken cognizance of its effect on many judicial decisions, including a very recent decision of this Court, declaring other legal areas as non-arbitrable, *e.g.*, anti-trust, patent, and racial discrimination.[7] Under the rationale of the opinion, a party should likewise be denied access to our courts in these other areas if there is a stipulation to arbitrate and if the transaction is "international".

We respectfully petition the Court to grant rehearing of this case, to reconsider its decision, and to affirm the judgment of the courts below. Before finally concluding, it may be helpful to the Court to elicit the views of the

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[7] See Respondent's Brief, page 18.

Securities and Exchange Commission with respect to the effect of the decision on the enforcement of our securities regulatory system.

Dated: July 12, 1974

Respectfully submitted,

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## CERTIFICATE OF COUNSEL

Francis J. Higgins certifies that he is one of the attorneys of record for Respondent Alberto-Culver Company and that the foregoing Petition for Rehearing is presented in good faith and not for delay.

(s) FRANCIS J. HIGGINS